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SUBJECT: SERBIA: STILL NO GRAND ECONOMIC STRATEGY

REF: A) Belgrade 1175 B) Belgrade 864

Summary

1. (SBU) Serbia has so far escaped the worst of the initial effects of the global financial crisis. The economy is slowing and the government faces a difficult 2009 with declining revenues, a sharp slowdown in economic growth, increasing spending demands from the diverse government coalition and a bleak outlook for investment inflows. The Serbian government does not have a unified policy or set of priorities to guide its economic path and to soften the blow. The 2009 budget process highlights the government's ad hoc approach and parochial/party interests that are driving internal debate. The government continues to muddle through the necessary choices on pensions, public sector wages and infrastructure investment. End Summary.

Financial Crisis Begins to Bite

2. (SBU) Some members of the Serbian government recognize that the global financial crisis has already begun to affect Serbia's economy and the government has taken some steps, including an IMF stand-by arrangement (ref A), to respond. However, the government as a whole does not have a comprehensive economic strategy and or a clear economic policy leader, so to date government initiatives have been poorly coordinated and have taken a more shotgun approach to economic reform and stimulus. The many political parties in the coalition have not yet unified under a strategy or goal and are pursuing parochial interests of their own ministries and parties.

3. (SBU) In a November 21 meeting with the Ambassador, Finance Minister Dragutinovic (DS) outlined the economic challenge. October government revenues were much lower than projected, which made the 2008 budget rebalance that was passed in September even more costly, as the government could not cover some of the planned expenditure increases. Dragutinovic said the IMF deal was important, and that it would be challenging to get agreement on a 2009 budget that met the IMF-agreed 1.5% of GDP deficit target for the consolidated budget deficit. She admitted that the national-level budget deficit would actually be 1.9% of GDP and that the difference would be made up with "surpluses" in other areas. The government revised the official 2009 GDP growth estimate further down to 3-3.5% from 4% just a few weeks ago. Vlada Cupic, the Chairman of Hypo Bank, told us on November 14 that he predicted GDP growth in 2009 of between 0.5% and 1.5%.

Budget - Every Ministry/Party for Itself

4. (SBU) The back room negotiations on the 2009 Serbian budget highlight the lack of clear economic priorities and the difficulty of building consensus among the diverse parties and interests in the governing coalition. The only economic message that every government official in Belgrade uses is the need to invest in

infrastructure, specifically the Corridor 10 (ref B) highway project linking Serbia to Hungary and Macedonia. Beyond Corridor 10 the ministries and ministers fall back to protecting their turf and their party interests. Janko Guzian, the Finance Ministry State Secretary with the unenviable task of preparing the budget, told us on October 28 that he had faced difficult battles with Ministers within President Tadic's Democratic Party (DS), Deputy PM Dinkic's G-17, the Pensioners Party (PUPS) and others. Interestingly, he commented that the only party in the coalition that was not making heavy spending demands was Deputy PM Dacic's Socialist Party (SPS).

15. (SBU) Dragutinovic complained that the government had not prioritized spending, which was especially important since resources next year would be scarce. As a technocrat with no previous political experience, Dragutinovic is poorly equipped to fight the bureaucratic and inter-ministerial political battles over spending. Ana Firtel, executive director of the Foreign Investors Council, expressed frustration to us on November 25 that the government had not set out its priorities and had not articulated an economic vision for Serbia.

#### Pensions and Wages - The Grand Compromise

16. (SBU) According to Dragutinovic, the 2009 budget froze pensions nominally next year, but public sector wages would increase in line with the cost of living. This was the compromise necessary to bring PUPS on board with the IMF restrictions on budget spending. This formula meant that the government would not have to rescind the 10% extraordinary pension increase passed in September. The details of this compromise have not been fully absorbed by the Serbian public and it is unclear how unions and labor will react after two years with wage increases well above inflation. Dragutinovic said that

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she had a positive meeting with leaders from the teachers union to reach out and explain the economic situation, but much more work with labor will be necessary.

Comment

17. (SBU) The Serbian government lacks a clear economic vision to carry them through the financial crisis. Prime Minister Cvetkovic, an economist, has excellent economic credentials, but President Tadic chose him to lead this government because of his managerial skills and his ability to identify issues where government consensus is possible and move ahead with those items. He has respect inside the government for his management, but he is not the public face of the government, nor is his style to impose discipline on the diverse government leadership. As a result, the four Deputy Prime Ministers -- Dacic (responsible for justice and police), Djelic (responsible for EU integration), Dinkic (responsible for domestic economic development), and Krkobabic (pensions) -- are more active in public pressing their individual economic agendas, leaving the public without a coherent vision for Serbia's economic future. The Serbian economic situation will be difficult in 2009 and the government must pass the test of agreeing to a responsible budget in the coming weeks. The budget will pass, likely with some difficulty, but Serbia's real challenge will be to move from reacting to each economic hurdle individually and prioritize the economic agenda to minimize the effects of the financial crisis while advancing the European vision that got this government elected. End Comment.

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